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SUBJECT: Eskom Faces Challenges - Thin Margin and More

Ref: A) Pretoria 1751 and previous
B) Maputo 1018
C) Gaborone 818

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11. (SBU) SUMMARY: A meeting with new Eskom Chairman Bobby Godsell was a good opportunity to assess the state-of-play in South Africa's power crisis. Godsell's new position is emblematic of Eskom's serious attempts to address a confluence of management gaps that led to last year's load-shedding. Eskom's reserve margin remains tight, bringing on new supply is long-term and difficult, and Eskom struggles to obtain greater demand reduction. Higher Southern Hemisphere summer demand and planned maintenance for plants being run at high loads places Eskom in a vulnerable position. Eskom will likely only use load-shedding as a last resort, but consumers may be faced with outages, depending on the success of demand reduction, implementation of new management practices, and the ability to finance new capacity in the midst of the global financial crisis.
END SUMMARY.

Need for Expansion and Comprehensive Planning

12. (SBU) State power utility Eskom's new Chairman Bobby Godsell (protect) told a visiting International Trade Commission delegation and Minerals/Energy Specialist in an October 15 meeting that he is focused on implementing Eskom's ambitious expansion program. He admitted that Eskom will not be able to immediately increase the thin five percent reserve margin it currently faces, rendering South Africa's power supply precarious and vulnerable. Godsell said Eskom aimed to build 40,000 MW of new capacity over the next 20-25 years, doubling existing capacity, to meet growth and restore the reserve margin to safer levels. He averred that slower growth in South Africa could reduce this need or spread it out over a longer period. On Eskom's current drawing board are three base-load, coal-fired power plants, two peaking, open-cycle, gas-fired plants, and two pump/storage hydro projects. Godsell said the SAG needed to establish a comprehensive energy policy based on a national energy debate on sources and uses of energy, instead of the current confusion with three separate ad hoc energy plans. He noted that Eskom reports to various, overlapping layers of government. Recent press reports have high-lighted Eskom's challenge in raising funds overseas in the current global credit turmoil.

Getting the Price Right is Hard to Do

13. (SBU) Godsell cited the following elements for Eskom's short-term plan to address shortages until new base-load plants come on line 2013-14:

- Aim to price electricity more realistically (South Africa has enjoyed the cheapest electricity in the world at 1-2 U.S. cents per kilowatt hour);
- Reduce consumption by ten percent across the board;
- Bring three moth-balled power plants back on line;
- Support Treasury's efforts to keep inflation under control, given the SAG's commitment to keep electricity price rises for the poor no more than inflation;
- Gain larger price increases for other user classes: up to twice inflation for higher-income users and up to three times inflation for industrial users.

Godsell noted that Eskom had gained a 60 percent nominal increase in electricity prices this year through two separate applications to the National Energy Regulator (NERSA). Godsell stated that, at a minimum, Eskom must recoup production costs, now comprising:

- Average recovered tariff: 0.25 Rand/kilowatt-hour

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- Cost of production: 0.5 Rand/kwh
- Cost of production and distribution: 0.75 Rand/kwh

(In other words, Eskom is losing up to 0.50 Rand/kwh, although approved price increases will whittle away at this loss per unit produced/sold.)

Getting the price to consumers right remains an immense political and regulatory challenge.

14. (SBU) Eskom has increased coal stockpiles and has broadly and successfully imposed a 10 percent reduction on large industrial users. Deeper mines have negotiated this reduction to 5 percent. Eskom continues to "jaw-bone" other consumers to reduce consumption, holding load-shedding as a threat. Eskom is working with the regulator on establishing financial penalties for consumers and municipalities that use more than their quota, but has faced criticism that it is employing an ineffective "one-size-fits-all" approach. Eskom is refining its demand side management program and incentives. New Minister for Public Enterprises Brigitte Mabandla said South Africa may face fresh power cuts early in 2009 because "voluntary energy savings have fallen woefully below the required 10 percent."

Nuclear Challenge Mounts - Need to Secure Funding

15. (SBU) Godsell noted that SAG nuclear policy aimed to increase nuclear from the current 2,000 MW to 20,000 MW, about one-half of the planned new build. Godsell said the contract for new nuclear build - for which Westinghouse and Areva of France are competing - has not been awarded yet because there is no firm funding in place. Godsell said that the Eskom Board has requested approval for the SAG to guarantee the debt incurred for building the first nuclear plant. The SAG still has not made a decision, but Godsell hopes to proceed with one nuclear plant by early next year. (NOTE: Eskom has publicly insisted that a decision will be made this year, but Westinghouse anticipates a high probability of delay to early next year or after the April/May elections (Septel). End Note.) Eskom

Chairman Jacob Maroga told investors in New York that financing for Eskom's capital expansion, including nuclear, was still up in the air and may require additional time. He noted that Eskom might start asking its suppliers to assist in co-finance of its purchases of equipment. Minister Mabandla was quoted in the press saying "no final decision on nuclear had been made and the real challenge that we have to overcome is the cost of the nuclear-build relative to the cost of a coal-build." An energy analyst, quoted in the investigative weekly Mail & Guardian, said "as far as I know the number one reason it keeps being deferred is money. A further factor was the new guys taking over from the old and not liking the decisions of the old."

Commitment to Renewables

¶16. (SBU) Godsell noted that the SAG aimed to achieve the goal of renewables comprising ten percent of new generation. He supported this goal, but stated that Eskom was best suited to deliver large scale generation, transmission, and distribution. Eskom is very good at building and maintaining large coal-fired plants; even nuclear would be outside of its main experience. Eskom was not the body to focus on renewables, he said. Godsell noted that Mozambique's Cahora Bassa hydroelectric facility had significant capacity for expansion that could help supply the region, but transmission was an issue (Reftel B).

¶17. (SBU) Godsell was frustrated with the SAG and Eskom's inability to establish Independent Power Producers (IPPs) in South Africa. He questioned whether a rational investor would enter the current South African market without a clear, transparent energy policy and with the current price and cost structure. Godsell said the SAG's stated goal of 30 percent of generation coming from IPPs was not realistic.

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He pointed at the Mmamabula coal-fired project in Botswana as an IPP with real potential, but noted that it was experiencing significant problems, and wondered whether it would actually be built (Reftel C). Godsell stressed that the government must play a stronger role in fighting corruption and promoting good governance and cooperation with the private sector, citing partnerships with the likes of Anglo American, BHP-Billiton, and Rio Tinto. Government and private stakeholders must cooperate to put together complex infrastructure deals.

¶18. (SBU) COMMENT: Former Anglo Gold Ashanti CEO Bobby Godsell's posting as Eskom's Chairman of the Board has been broadly applauded. He brings a useful mix of experience, pragmatism, charisma, and struggle credentials to Eskom's challenges. Eskom's challenging five-year expansion budget has ballooned from Rand 150 billion to Rand 343 billion (with press reports predicting as high as Rand 400-500 billion - about \$50 billion) because of the increased construction costs for the same targeted plant due to production queues and component shortages, increased financing costs, and a weaker rand. Eskom may see its capital investment program pushed further off into the future, as the SAG and Eskom management reassess whether they can afford nuclear as a significant part of the mix. Analysts have noted that the cost of nuclear build is significantly higher than that for coal. The mission continues to support Westinghouse as it works to advance its bid for the first 3000 MW tranche of new nuclear build, even if the full fleet timing and prospects are less clear.

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